verenex energy inc.

2005 annual report

Verenex Energy Inc. ("Verenex" or the "Company") is a Canada-based, international oil and gas exploration and production company with a world-class exploration portfolio in the Ghadames Basin in Libya and the Bay of Biscay offshore France.

Old Berber village in Nalut, Libya, adjacent to Area 47.

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Verenex Energy Inc. ("Verenex" or the "Company") is a Canada-based, international oil and gas exploration and production company with a world-class exploration portfolio in the Ghadames Basin in Libya and the Bay of Biscay offshore France.

Verenex was established by Vermilion Energy Trust ("Vermilion") in March 2004 to advance the exploration program that Vermilion had begun in France, prior to its conversion to an income trust in 2003, and to pursue other international exploration, development and acquisition opportunities outside Canada.

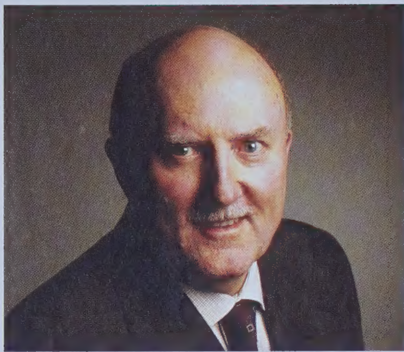
Verenex is a public company that resulted from the amalgamation of a formerly private company, Verenex Energy Inc., a wholly owned subsidiary of Vermilion, and Prairie Fire Oil & Gas Ltd. under the laws of the Province of Alberta on June 29, 2004.

In conjunction with the amalgamation, Verenex successfully completed a Founders' Private Placement and Secondary Private Placement with investors in Canada, the US and Europe to raise Cdn $30.8 million (gross before fees) in equity. By virtue of its participation in the Secondary Private Placement and its transfer to Verenex of participating interests in Vermilion exploration lands in France and a royalty on a producing oil and gas asset held by Vermilion in Alberta, Canada, Vermilion retained a significant interest in Verenex. In December 2005, Verenex conducted a Cdn $26.1 million (gross before fees) equity financing in which Vermilion again participated. Vermilion currently holds a 49.3% interest in Verenex.

Verenex was listed for trading on the TSX Venture Exchange in Canada on July 20, 2004 and subsequently graduated to the Toronto Stock Exchange on April 19, 2005.

highlights

Financial (thousands of Cdn $, except share and per share amounts)	**Twelve Months Ended December 31, 2005**	Period Ended December 31, 2004
Royalty income	**$ 2,118**	$ 487
Funds from operations	**942**	332
Capital expenditures	**10,952**	16,586
Working capital surplus	**$ 33,665**	$ 18,282
Common shares outstanding		
Basic	**30,830,433**	22,514,600
Diluted	**35,364,183**	25,993,850
Weighted average common shares outstanding		
Basic	**22,971,271**	22,511,646
Diluted	**24,517,041**	22,743,320
Share trading		
High	**$ 7.25**	$ 4.25
Low	**$ 3.00**	$ 2.15
Close	**$ 3.21**	$ 4.25
Operations		
Production		
Crude oil (bbls/d)	**31**	–
Natural gas liquids (bbls/d)	**19**	16
Natural gas (mcf/d)	**396**	368
Boe/d (6:1)	**116**	77
Average reference price		
WTI (US per bbl)	**$ 56.56**	$ 41.40
Brent (US per bbl)	**54.38**	38.22
AECO (Cdn per mcf)	**8.77**	6.56
Average selling price		
Crude oil (Cdn per bbl)	**64.97**	–
Natural gas liquids (Cdn per bbl)	**50.47**	43.15
Natural gas (Cdn per mcf)	**$ 7.40**	$ 5.24



I would like to thank our shareholders for their ongoing support and their confidence in providing new funding in 2005. As we gear up to drill in Libya, I am confident that patience will be rewarded. We can and will make it happen.

James D. McFarland
President & CEO

president's report

It is my pleasure to summarize our Company's progress in 2005, the first full year of operations.

2005 was an exciting year in the short history of Verenex. We began the year with a portfolio of exploration lands in France and a small overriding royalty in Canada acquired from Vermilion Energy Trust ("Vermilion") in June 2004. By January 2005 we had scored a major breakthrough in winning a 50% interest and operatorship of a large exploration block in Libya called Area 47. North Africa is a strategic focus of the Company and securing a position in Libya so quickly provides a platform for early growth in this region.

Our Company is in the unique position of being the smallest operator to have won an exploration contract in Libya. Our 50% partner in Area 47 is PT Medco Energi Internasional Tbk ("Medco"), a large Indonesia-based energy company that produces about 80,000 barrels of oil equivalent per day. We are pleased with this partnership and both companies share a desire to aggressively explore and develop Area 47.

Our timing in entering Libya could not have been better. Although the fiscal terms for new exploration rights in Libya are tough and we bid aggressively in the First Bid Round in January 2005 to win exploration rights in Area 47, the second bid round in October 2005 proved to be even more competitive and effectively validated our entry strategy. Other operators to the south of us in the same petroleum basin were willing to bid down their share of production by almost half compared to our bid for Area 47.

"We now have a high impact exploration portfolio in Libya and in offshore France, with an inventory of prospects and leads to support a drilling program for years to come."

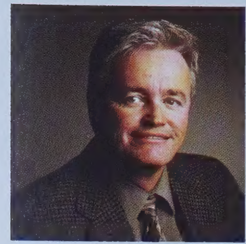
We now have a high impact exploration portfolio in Libya and in offshore France, with an inventory of prospects and leads to support a drilling program for years to come. We are poised to test our Libya block with the drill bit in 2006. Offshore France is targeted for 2007.

Libya stands out as one of the hottest exploration plays in the world after emerging in 2004 from 20 years of US and UN sanctions. Libya is the eighth largest oil producer in the world and an important supplier of light sweet crude. The country is targeting to double its oil production to three million barrels per day in 10 years and has opened its doors to the international petroleum industry.

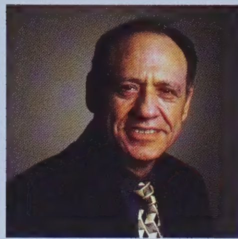
The Libyan government carried out two very successful and highly contested auctions of oil and gas exploration rights in 2005, the first such auctions in its history. Thirty-eight new contract areas were awarded to some of the biggest US and other international oil companies as well as a number of large national oil companies. The high level of interest in these bid rounds is a measure of the country's hydrocarbon prospectivity and opportunity for value creation.

We are very excited about the oil potential in Area 47. It is located in the Ghadames Basin, a proven producing basin in northwest Libya, just 130 kilometres south of Tripoli. The block is very large, measuring 6,182 square kilometres or 1.5 million acres, with excellent access by road. We believe Area 47 has world class exploration potential with estimated gross recoverable resources of light sweet crude oil that could exceed 500 million barrels.

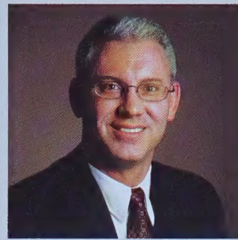
There are already three oil discoveries on the block that we can appraise and hold if deemed commercial. Under the contract for Area 47, we have a five-year exploration phase to discover and appraise as much resource as possible. Fields declared commercial can be held and produced for 25 years, with the Libyan National Oil Corporation ("NOC") backing-in for a 50% working interest. To-date, we have identified an inventory of 25 prospects and leads on existing seismic and well control. We expect this inventory to grow as additional seismic data is made available to us by the NOC and



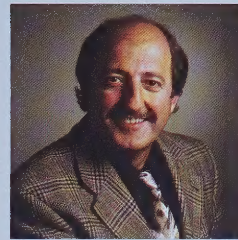
Blair Anderson,
Manager, Exploration



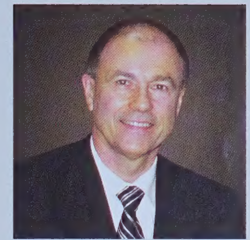
Giuseppe (Joe) Arcuri,
Manager, Geophysics



Ken D. Hillier, C.A.,
Chief Financial Officer



Fadi Nammour, P. Eng.,
Manager, Business Development & Operations



Don Shepherd, P. Eng.,
General Manager, Libya

the management team

as results become available from an extensive seismic program we are shooting in 2006. We are therefore planning an aggressive exploration and appraisal drilling program over the next four years that could exceed 30 wells.

> "Our small experienced team of people made a big impact in 2005. The team is skilled in building relationships, finding and exploiting opportunities and creating value."

In 2005 we were successful in establishing an office and start-up organization in Tripoli, developing a multi-year work program for Area 47, achieving partner and NOC approvals for the 2006 budget and securing the capital to fund the Company's 50% share of the 2006 program.

We are targeting to invest about Cdn $29 million (net) in Libya in 2006 including seismic, four wells and a workover on an existing oil discovery well. Expenditure pace will be dictated by how quickly we can contract one or more drilling rigs. We kicked off the work program in late December 2005 with the start of our large 3-D and 2-D seismic programs that will extend into the fourth quarter of 2006. We are poised to begin drilling in 2006 as soon as we can contract a suitable drilling rig.

In France, onshore exploratory drilling results in 2004 and 2005 were disappointing, with a 2005 exit rate of only 130 barrels of oil per day. However, the most exciting high impact exploration opportunity in the France portfolio is the 1,200 square kilometre offshore Aquitaine Maritime Permit (Verenex 50%) which is operated by Vermilion. This project was advanced in 2005 with completion of an extensive 3-D and 2-D seismic shoot in late October. Processing and interpretation should be completed in April 2006 to position partnering discussions and potential first drilling in the second half of 2007.

Our Company is in good financial shape. In December 2005 we successfully raised gross proceeds of $26.1 million in a bought-deal financing, increasing working capital to $33.7 million at year-end 2005. These funds will be sufficient to carry out our planned 2006 work programs in Libya and France.

Our small experienced team of people made a big impact in 2005. The team is skilled in building relationships, finding and exploiting opportunities and creating value. Our success in securing a position in Libya in the face of strong international competition is a measure of these skills. I would like to thank each of them for their hard work and continuing commitment to the Company's success.

Finally, I would like to thank our shareholders for their ongoing support and their confidence in providing new funding in 2005. As we gear up to drill in Libya, I am confident that patience will be rewarded. We can and will make it happen.

JD McFarland

James D. McFarland
President & Chief Executive Officer
February 23, 2006

review of operations > libya

Seismic crew laying geophone cables for the Company's first 3-D seismic survey in Area 47 in Libya.

Signing ceremony for the Area 47 exploration and production sharing agreement March 12, 2005 in Tripoli, Libya.

Mr. Abdulla S. El Badri, Chairman of the NOC Management Committee, signing on behalf of the NOC and Mr. Jim McFarland and Mr. Robert Christensen (Director of Verenex Energy Area 47 Libya Limited) signing on behalf of Verenex.

Libya

When Verenex was established in June 2004, the Company's E&P portfolio was limited and included exploration lands in France and a gross overriding royalty in Canada. However, the Company set a goal to expand this portfolio to include North Africa given the oil and gas opportunities in this region.

One opportunity that immediately attracted the Company's attention was Libya's plan to hold its first international auction of exploration rights in January 2005. The Company applied in September 2004 to be qualified to bid in the First Bid Round in Libya and was subsequently approved as an operator, a significant accomplishment in itself given the small size of the Company. Vermilion Energy Trust's ("Vermilion") major shareholding in the Company was an important consideration in the qualification process.

On the strength of the Company's status as an operator, a number of other companies approached Verenex to team up for the bid round. In reviewing the options, the Company chose to partner with PT Medco Energi Internasional Tbk ("Medco"), a large Indonesia-based energy company, which had also qualified as an operator. The two companies assessed four blocks in the First Bid Round and submitted joint bids on two blocks, one of which was successful for exploration rights in Area 47.

Area 47

Area 47 is a large 6,182 square kilometre block in the Ghadames Basin in northwest Libya. Verenex is operator of the block with a 50% interest and Medco holds the remaining 50% interest. The companies signed an exploration and production sharing agreement ("EPSA") for Area 47 with the NOC on March 12, 2005 and it was ratified by the Libyan government effective March 30, 2005.

The EPSA sets out the required minimum work program during the initial five-year exploration and appraisal period and defines the terms for development, during a 25-year exploitation period, of any commercial discoveries made during the initial five-year period. Land that is not held by a commercial discovery as at March 30, 2010 is returned to the government.

Under the terms of the EPSA for Area 47, Verenex and Medco are required to shoot new seismic, including 1,000 kilometres of 2-D and 200 square kilometres of 3-D, and drill three "new-field wildcat" exploration wells during the five-year exploration and appraisal period. All costs during this period, including the minimum commitment program and any additional seismic and drilling, will be borne 100% by Verenex and Medco.

Prospectivity

Area 47 is located in the Ghadames Basin, a proven producing basin in northwestern Libya that extends through southern Tunisia and into northeastern Algeria, where it is known as the Berkine Basin, a prolific hydrocarbon bearing region that has seen major discoveries in the past few years. A recent, comprehensive study by Beicip Franlab, in association with the Libyan Petroleum Research Centre, states that about 2.7 billion barrels of oil equivalent has been found in 54 fields in the Ghadames Basin in Libya. Exploration drilling density is less than one well per 1,000 square kilometres, with an exploration drilling success rate of more than 60% in the vicinity of Area 47. The largest field found to-date is al Wafa, located in the southwestern part of the basin, with estimated recoverable reserves of four trillion cubic feet of liquids-rich gas. This field came on-stream in October 2004.

Much of the oil found in the basin resulting from a number of drilling campaigns since the 1960s remains undeveloped. Until recently, there had been limited pipeline infrastructure in the immediate vicinity of Area 47 and insufficient investment in drilling to build

The Company applied in September 2004 to be qualified to bid in the First Bid Round in Libya and was subsequently approved as an operator, a significant accomplishment in itself given the small size of the Company.

Typical terrain in Area 47 in Libya.

a threshold oil reserve to justify a new pipeline under prevailing crude oil prices. Individual oil discoveries in the region were generally small by Libyan standards, ranging in size from five to 50 million barrels. However giant field discoveries in the 1990s in the Ghadames Basin (al Wafa) and in the Murzuq Basin (Elephant) to the south have changed the pipeline infrastructure picture. New pipelines from these discoveries have been built to the Libyan coast and these pass through the Ghadames Basin. The most recent development was the October 2004 start-up of a 16" oil and condensate line and a 32" gas line from the al Wafa field. These two lines traverse the northwest corner of Area 47.

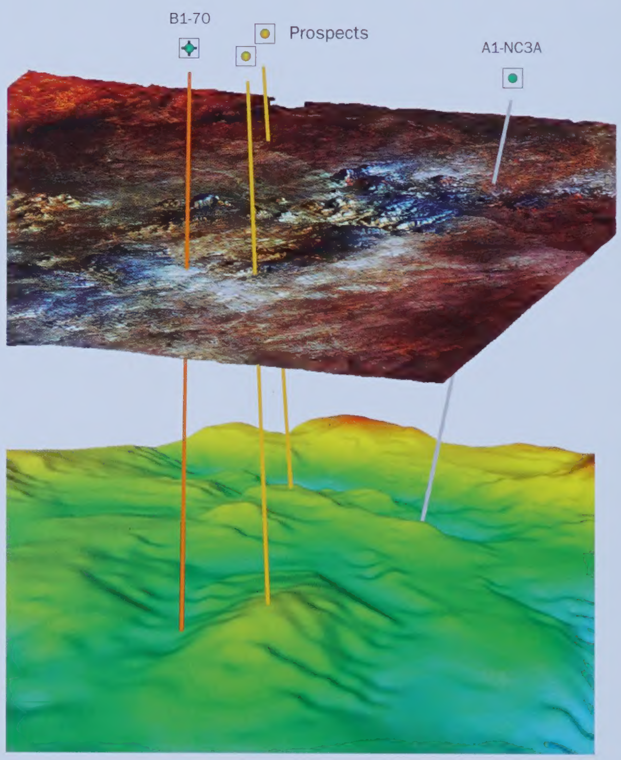
A total of seven wells have been drilled in or on the boundary line of Area 47 since the early 1960s, a drilling density of about one well per 880 square kilometres. Three of these wells are classified as oil discoveries by the NOC, including B1-70 and A1-NC3A in the south and G1-NC02 in the central part of the block. These wells were tested but have never been produced and remain suspended as potential oil producers. A fourth well A1-61 in the northern part of the block drilled in 1961 had excellent oil shows but was abandoned.

Based on the seismic and well control data provided to date by the NOC for the First Bid Round, the Company has identified an inventory of 25 prospects and leads that have been grouped in three project areas in the northern, central and southern parts of Area 47. The Company believes that in aggregate these prospects and leads have unrisked mean potential recoverable oil resources in excess of 500 million barrels. The Company also believes there is good potential for this inventory of prospects and leads and associated resource potential to grow as additional existing seismic data is acquired from the NOC and as new seismic is shot in 2006.

Operations

In 2005, the Company designed an extensive seismic program for implementation in 2006, including two 3-D seismic surveys in the south and central project areas of Area 47, totalling 480 square kilometres, and 1,500 kilometres of 2-D seismic in the north and south project areas. This program exceeds the minimum commitment required under the EPSA contract.

Six drillable prospects were also defined, based on existing seismic and well control, and these were ranked for drilling starting in 2006. Although the Company considers these to be drill-ready now, the new seismic being shot in 2006 will be available before drilling and will serve to optimize specific well locations.



Libya – Area 47: Quickbird (2005) satellite image of south 3-D project area with 3-D visualization of base Lower Acacus (reservoir) structure illustrating several prospects and leads (high relief reds, yellows and greens).

In December 2005, the Company received approval from the Area 47 Management Committee ("Area 47 MC"), which includes representatives from Verenex, Medco and the NOC, for its proposed 2006 work program and budget totalling US $48 million (gross) or Cdn $29 million (net Verenex 50% share). The planned 2006 program includes:

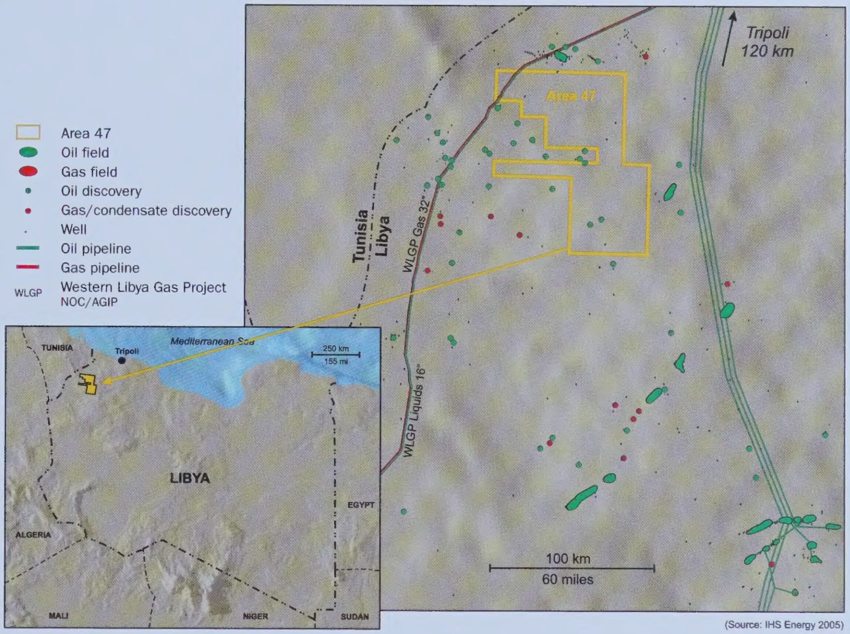
- Four wells to test prospects adjacent to the existing B1-70, A1-NC3A, A1-61 and G1-NC02 wells.
- A workover and production test on the A1-NC3A suspended oil discovery well.

A total of seven wells have been drilled in or on the boundary line of Area 47 since the early 1960s, a drilling density of about one well per 880 square kilometres. Three of these wells are classified as oil discoveries by the NOC, including B1-70 and A1-NC3A in the south and G1-NC02 in the central part of the block.

A1–NC3A oil discovery (1998) in Lower Acacus formation.

- 480 square kilometres of 3-D seismic and 1,500 kilometres of 2-D seismic.

The seismic contract was awarded in November 2005 and surveying began in late December for the initial 243 square kilometre 3-D seismic shoot in the southern project area. This area encompasses the two existing oil discoveries at B1-70 and A1-NC3A and two of the four planned well locations in 2006. This survey was completed in mid-March 2006 and initial interpreted results should be available in mid-April.



(Source: IHS Energy 2005)

The Company continues to optimize the 2006 seismic program, which is expected to extend into the fourth quarter, as its database and understanding of Area 47 and the Ghadames Basin grows. The Company is currently planning to reconfigure the 2-D component of the seismic program in the southern part of Area 47 to include a number of new leads identified towards the eastern boundary of the block. These areas are on trend and between the Area 47 discoveries at B1-70 and A1-NC3A and two recently reported oil discoveries by the Arabian Gulf Oil Company ("AGOCO"), an NOC affiliate, near the Tlacsin field approximately 12 kilometres east of Area 47.

The Company is now poised to begin drilling the first of four wells budgeted in 2006 as soon as a drilling rig can be contracted.

Tender documents were issued to 10 drilling contractors in December 2005. The Company has received a number of quotations for up to two drilling rigs, potentially available at staggered times in 2006, and is nearing completion of bid evaluations and selected rig inspections. The Company is targeting to award a contract by April 2006 for at least one rig to start drilling as soon as possible thereafter.

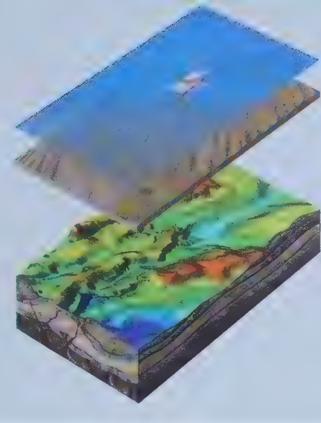
The Company also issued tender documents for casing, tubing, wellheads and other drilling supplies in December 2005 to equip four 12,000 foot exploration and appraisal wells. The Company awarded a contract for casing and tubing for four wells in late February 2006 to a supplier who could provide in-stock material. Delivery of the materials to Libya is expected to be completed by the end of April 2006, which has removed this procurement step as a potential critical path item for drilling.

The Company is currently working with a number of consultants to develop the mechanical design of the well completions and to develop the program for a full suite of logging runs and production tests for the planned workover on the suspended A1-NC3A well and for each of the new wells to be drilled. This work is expected to be completed by the end of March 2006 to support tendering for a service rig that would initially carry out a workover on the A1-NC3A well. AGOCO drilled this well in 1998 and, based on drillstem test results, calculated an estimated producibility of 7,500 barrels of oil per day from two zones. Verenex plans to re-enter and log the well, perforate productive zones, carry out an extended production test to confirm deliverability and capture additional well and fluid data to support reserve assessments and development planning.

review of operations > france

3-D seismic acquisition on the Aquitaine Maritime permit in the Bay of Biscay.

Verenex has a 50% participating interest (Vermilion holds the other 50% and is the operator) in the 1,200 square kilometre Aquitaine Maritime offshore exploration permit. This permit is located in the Bay of Biscay approximately 45 kilometres off the coast of southwest France on the same exploration fairway as the northern edge of the proven onshore Parentis Sub-Basin.



Visualization of Top of Lower Cretaceous structure (pre-2005 seismic data) in the Aquitaine Maritime permit.

France

In France, the Company holds participating interests in a total of five exploration permits in the Paris Basin and Aquitaine Basin which were acquired from Vermilion in 2004. These participating interests range from 31.67% to 95%, representing 561,557 net acres.

In the fourth quarter of 2004, the Company drilled two technically challenging, horizontal oil wells at St. Lazare and Parentis, each with a 95% participating interest, which were completed and tested in March and April 2005. Oil production results were lower than expected and, as a result, the Company put its planned follow-up drilling program in these areas on hold, pending sustained performance results from the first two wells.

Marvilliers Permit

The Company's first exploration well in France was at St. Lazare 2H in the Marvilliers Permit in the Paris Basin. This horizontal well was drilled to test a possible extension to the Malnoue field operated by Vermilion. The 488 metre open-hole horizontal section of the well in the Dogger formation was tested in March 2005 at oil rates as high as 150 barrels per day (gross). However, the well quickly watered-out and was suspended in April 2005.

The Company re-entered the St. Lazare 2H well in September 2005 and cemented a liner in the open-hole horizontal section of the well. The liner was selectively perforated near the end of the horizontal section to isolate areas of suspected water influx. The well was placed on production in late October 2005 and produced at an average rate of 118 barrels of oil per day (net Verenex 95% share) in November and December 2005 with minimal water. In March 2006, the well was producing about 80 barrels of oil per day (net) at a watercut of 25%.

The Company is continuing to monitor oil and water production performance of the well and is evaluating the potential for follow-up drilling.

Parentis Concession

Vermilion granted Verenex the right to drill two infill wells, each with a 95% Verenex participating interest, in the Parentis concession, a producing oil field in southwest France. Drilling of the first infill well Parentis 222H was completed in December 2004 and targeted potential bypassed oil near the crest of the structure. It was drilled to a depth of approximately 2,000 metres and completed with a 702 metre open-hole horizontal section in the Lower Aptian carbonate formation. The well was completed and acidized in late March 2005 and placed on production. The well produced at a much lower than expected initial oil rate of 45 to 50 barrels per day (gross) with a watercut of approximately 65%. Oil production averaged 33 barrels per day (net Verenex 95% share) in the fourth quarter of 2005. In March 2006, the well was producing about 30 barrels per day (net) with a watercut of 65%.

The Company is evaluating the merits of injecting water in offsetting wells owned by Vermilion in order to increase reservoir pressure and fluid production.

Nemours Permit

The Company participated in the Lundin-operated La Tonnelle 1 exploration well in the Nemours Permit (Verenex 31.67%), which was completed in October 2005, but failed to find productive hydrocarbons. The Company chose not to participate in a subsequent sidetrack operation which found a potentially productive section in the Chaunoy formation. After assessing potential well productivity and economics, the Company waived its option to participate, which would have required payment of a 600% penalty on the sidetrack costs.

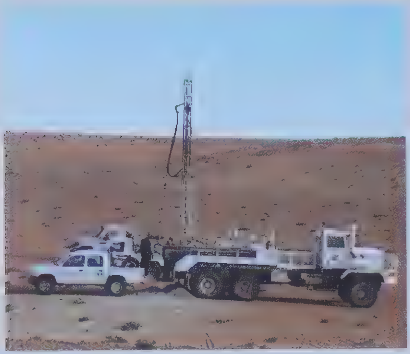
Other Onshore Permits

Geological and geophysical studies will be carried out in 2006 to advance the assessment of the exploration potential on the St. Valerien and Chateau Landon permits.

Aquitaine Maritime Offshore Permit

Verenex has a 50% participating interest (Vermilion holds the other 50% and is the operator) in the 1,200 square kilometre Aquitaine Maritime offshore exploration permit. This permit is located in the Bay of Biscay approximately 45 kilometres off the coast of southwest France on the same exploration fairway as the northern edge of the proven onshore Parentis Sub-Basin.

In October 2005, a 775 square kilometre 3-D and 462 kilometre 2-D seismic shoot was completed on the permit. The new seismic is expected to be fully interpreted by the end of April 2006. Vermilion and Verenex are seeking an additional partner in the project to take on the drilling portion of the exploration program. The current plan is to drill one or two wells in the second half of 2007 to test this world-class exploration opportunity.



Verenex holds a 50% working interest in Area 47, a 6,182 square kilometre block in the Ghadames Basin in Libya. The Company also holds participating interests in a total of five exploration permits in the Paris Basin and Aquitaine Basin in France with participating interests ranging from 31.67% to 95%.

Drilling of shallow "up-holes" for 3-D seismic survey in Area 47 in Libya.

review of operations

Other North Africa

The Company is seeking to expand its current Libyan position and to build a portfolio in North Africa with short, medium and long-term time horizons. Opportunities are being pursued to access early production from mature and marginal fields and other discovered resources that are not fully developed. New exploration concession awards will also be pursued.

In Algeria, Verenex qualified to bid as a consortium member in the Sixth Bid Round, which was completed in April 2005. The bid round, which included ten large areas, attracted strong interest from the international oil and gas industry. Verenex teamed up with Medco and bid on one block in northeast Algeria but the bid was unsuccessful.

A Seventh Bid Round is anticipated in 2006 under new terms. A new hydrocarbon law was promulgated in Algeria in 2005 which establishes a royalty and tax regime in new exploration bid rounds to replace the previous production sharing form of agreement. A new government department has been formed to manage exploration bid rounds, a role previously held by Sonatrach, the national oil company.

Other farm-in opportunities are being pursued in the region.

Canada

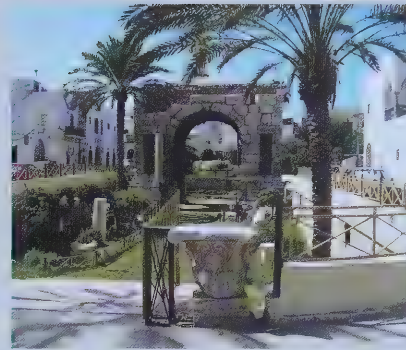
Pursuant to a royalty agreement dated May 27, 2004 between Vermilion and Verenex, Vermilion transferred to Verenex a 25% gross overriding royalty on certain of Vermilion's minor interest, non-operated producing oil and gas properties in the Bottrel area of Alberta (the "Bottrel GORR"). The Bottrel project area, located west of Calgary, contains 15 producing gas wells.

Land Position

Verenex holds a 50% working interest in Area 47, a 6,182 square kilometre block in the Ghadames Basin in Libya. The Company also holds participating interests in a total of five exploration permits in the Paris Basin and Aquitaine Basin in France with participating interests ranging from 31.67% to 95%. In addition, Vermilion granted Verenex the right to drill two infill wells, each with a 95% Verenex participating interest, in the Parentis concession, a producing oil field located in southwest France.

Permit	No.	Gross Area (acres)	Permit Expiry	Participating Interests (acres)		
				Verenex	Vermilion	Others
Libya – Ghadames Basin	Area 47	1,527,551	03/2010	763,776	–	763,775
Paris Basin						
Marvilliers	N541	48,927	06/2008	46,481	2,446	–
St. Valerien	M565	296,774	08/2007	281,935	14,839	–
Chateau Landon	DP–1496	82,780	06/2009	78,641	4,139	–
Nemours	DP–1498	15,732	06/2007	4,877	367	10,488
Aquitaine Basin						
Aquitaine Maritime	N548	299,245	12/2007	149,623	149,622	–
Total France		743,458		561,557	171,413	10,488
Total		2,271,009		1,325,333	171,413	774,263

During the year, the Company completed, tied-in and brought on production two wells in France, one in the Marvilliers permit (St. Lazare 2H) and the other in the Parentis concession (Parentis 222H). This resulted in the addition of 167,000 barrels (net) of proven reserves and 523,000 barrels (net) of proven plus probable reserves.



Roman ruins in downtown Tripoli, Libya.

Reserves

During the year, the Company completed, tied-in and brought on production two wells in France, one in the Marvilliers permit (St. Lazare 2H) and the other in the Parentis concession (Parentis 222H). This resulted in the addition of 167,000 barrels (net) of proven reserves and 523,000 barrels (net) of proven plus probable reserves.

GLJ Petroleum Consultants Ltd. ("GLJ"), independent petroleum engineering consultants in Calgary, have prepared the 2005 year-end reserve evaluation report for the Company's Bottrel GORR in Canada and its two wells in France. The report is in compliance with National Instrument 51-101. The Company's proved plus probable (P-50) reserves are approximately 795,000 barrels of oil equivalent at December 31, 2005. Based on anticipated production rates for 2006 of 175 barrels of oil equivalent per day, the Company's effective reserve life index at December 31, 2005 for proved (P-90) reserves is 6.0 years and for proved plus probable reserves (P-50) is 12.4 years.

The summary reserve statement as at December 31, 2005 is included below. The net present values of the reserves shown, which are based on GLJ's forecast prices and costs, are presented for comparative purposes only and are not representative of fair market value.

Summary of Reserves and Values Based on GLJ Forecast Prices and Costs

	Marketable Reserves								Net Present Values of Future Net Revenue Before Deducting Income Taxes Discounted At[3][4]		
	Oil		Natural Gas		Natural Gas Liquids		Oil Equivalent[5]				
	Gross[1] (mbbl)	Net[1] (mbbl)	Gross[1] (mmcf)	Net[1] (mmcf)	Gross[1] (mbbl)	Net[1] (mbbl)	Gross[1] (mboe)	Net[1] (mboe)	0% ($M)	10% ($M)	15% ($M)
Proved developed producing	178	167	–	725	–	36	178	324	14,064	9,888	8,774
Proved developed non-producing and proved undeveloped	–	–	–	289	–	11	–	59	2,555	1,166	881
Total proved[2]	178	167	–	1,014	–	47	178	383	16,619	11,054	9,655
Total proved plus probable[2]	540	523	–	1,269	–	60	540	795	28,569	15,569	12,739

1. "Gross Reserves" include the 100% working interest (operating or non-operating) share before deducting royalties (reserves in France) and without including any other royalty interests (Bottrel GORR). "Net Reserves" are the Company's working interest (operating or non-operating) share after deduction of royalty obligations, plus the Company's royalty interests in reserves. Values are in thousands of barrels ("mbbbl" or "mboe") and millions of cubic feet ("mmcf").
2. Under the 51-101 guidelines, proved reserves are qualified as those reserves that have a 90% chance of being exceeded at the reported level. Proved reserves, by definition, are conservative. Nine times out of 10, actual reserves will be greater than the proved estimate. Proved plus probable reserves are defined as those reserves that have a 50% probability of being exceeded at the reported level and are the best estimate, or the most realistic case. It is equally likely that the actual reserves will be higher or lower than the estimate.
3. No after tax values have been presented as the Company is not anticipated to be taxable for the foreseeable future. Values are in thousands of Canadian dollars ("$M").
4. Abandonment costs have not been included for the Bottrel GORR royalty interest as the Company does not participate in the costs. The Company will pay its share of gas processing fees as long as the annual royalty revenue is above $1,000,000. The processing fee is reimbursed when the royalty revenue falls below $1,000,000 and cannot, on its own, reduce the royalty revenue below $1,000,000.
5. "Oil Equivalent" represents the aggregate of the reserves disclosed under "Oil", "Natural Gas" and "Natural Gas Liquids", combined on the basis that 6,000 cubic feet of sales gas is equivalent to 1.0 boe.

management's discussion and analysis

Vibrator trucks recording the Company's first 3-D seismic survey in Area 47 in Libya

The following is management's discussion and analysis ("MD&A"), dated February 23, 2006, of the Company's operating and financial results for the year ended December 31, 2005. The financial data has been prepared in Canadian dollars in accordance with Canadian generally accepted accounting principles ("GAAP") applied consistently with prior periods. This discussion should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2005, together with the accompanying notes as contained in the Company's 2005 Annual Report.

Additional information relating to the Company, including its Annual Information Form, NI 51-101 disclosure and details of outstanding share data and the Company's Stock Option Plan, is available on SEDAR at **www.sedar.com.**

Highlights

2005 was a breakthrough year for Verenex. The Company, together with 50% partner PT Medco Energi Internasional TBK ("Medco"), signed an exploration and production sharing agreement ("EPSA") for Area 47 in the Ghadames Basin in Libya in March 2005, building on its exploration land holdings in France and royalty interest at Bottrel in Canada. Since signing the EPSA, the Company has made significant progress in firming its near term seismic and drilling programs in Area 47.

In Libya, the Company has identified six drill-ready prospects, based on existing seismic and well control and these have been ranked for drilling commencing in 2006. A seismic contract was awarded in November 2005 to acquire 480 square kilometres of 3-D and 1,500 kilometres of 2-D seismic in Area 47. The program commenced in late December 2005 and will be completed in the fourth quarter of 2006.

The Company is set to begin drilling the first of four wells budgeted for 2006 as soon as a drilling rig can be contracted. The Company has received a number of quotations for up to two drilling rigs, potentially available at staggered times in 2006, and is nearing completion of bid evaluations and selected rig inspections. The Company is targeting to award a contract in April 2006 for at least one rig to start drilling as soon as possible thereafter.

The Company appointed Don Shepherd as General Manager of its Tripoli office in January 2006. The office is now fully functional with an initial complement of eight employees, including three senior expatriates.

In France, Verenex completed the workover and tie-in of its St. Lazare 2H and Parentis 222H oil wells and the drilling of the unsuccessful La Tonnelle 1 exploration well on the Nemours permit. Oil production and reserves from these wells were lower than originally anticipated, leading to a $7.5 million non-cash ceiling test write-down at the year end. The Company exited the year with France oil production of approximately 130 barrels per day (net).

During the fourth quarter of 2005, the Company shot 775 square kilometres of 3-D and 462 kilometres of 2-D seismic on the offshore Aquitaine Maritime exploratory permit in the Bay of Biscay. Processing and interpretation of the data is targeted for completion by the end of April 2006. The France affiliates of Verenex and Vermilion each hold a 50% participating interest in the permit.

Forward-Looking Information

This report contains forward-looking financial and operational information including earnings, cash flow, production and capital investment projections. These projections are based on expectations and are subject to a number of risks and uncertainties that could materially affect the results. These risks include, but are not limited to, future commodity prices, exchange rates, interest rates, geological risk, drilling equipment availability, reserves risk, political risk, product demand, transportation restrictions and dependence on key personnel.

Non-GAAP Measures

Included in this report are references to terms commonly used in the oil and gas industry, such as cash flow and cash flow per share which is expressed before changes in non-cash working capital and are used by the Company to analyze operating performance, leverage and liquidity. These terms are not defined by GAAP. Consequently, these are referred to as non-GAAP measures. Cash flow, as discussed in this report, appears as a separate caption on the Company's cash flow statement and is reconciled to both net income and cash flow from operating activities.

Operating Results

Asset Valuation

The Company performs a review for asset impairment as required by the Full Cost Accounting Guideline, AcG-16. Any impairment in value is dependent upon an independent reservoir engineer's assessment of the deliverability and reserves associated with certain wells and the outlook for world prices for oil and natural gas.

The Company completed a review for asset impairment for the France full cost pool, including the St. Lazare 2H, Parentis 222H and La Tonnelle 1 wells. Based on an independent reservoir engineer's (GLJ Petroleum Consultants Ltd.) assessment of the deliverability and

reserves associated with the wells and the outlook for world prices for oil and natural gas, it was determined that a $7.5 million ceiling test non-cash write-down was required to reflect an impairment in these assets, including the investment to date in the expired permit at Les Trois Lagunes.

Revenues

Verenex commenced operations on June 29, 2004 and 2005 was the first full year of operations. On a full year basis, production increased from 77 to 116 barrels of oil equivalent per day. The Bottrel GORR provided 85 barrels of oil equivalent per day, up from 77 boe per day in 2004, and France contributed 31 barrels of oil per day. The Bottrel GORR results in 2005 were positively impacted by a production allocation adjustment in the first quarter relating to 2004.

In France, the Parentis 222H well was drilled in December 2004 and put on production in late March 2005. The Company completed a water shut off workover on its 2004 St. Lazare 2H well and placed it on pump in late October 2005. The Company undertook a long term production test of the Parentis well to determine whether additional workover or other remedial actions would improve performance of the well. Test production for the Parentis 222H well averaged 32 barrels of oil per day (net) in the second and third quarters of 2005. This production was excluded from the operating results, subject to assessing the potential of a workover and/or water injection to increase reservoir pressure and production rates. The Company recognized a credit to capital of approximately $0.3 million against its investments in the France wells. This credit reflects net operating revenues (after royalties, operating and transportation costs).

During the fourth quarter of 2005, the Company determined that both the St. Lazare 2H and the Parentis 222H wells were commercial on a go forward basis and the associated revenues, expenses and depletion costs were therefore included in the Company's operating results, effective October 1, 2005.

Total oil and gas related revenues increased to $2.2 million, net of royalties, from $0.5 million in 2004. Total year 2005 results were positively impacted by the addition of the France production and the production allocation adjustment in the first quarter relating to 2004. There were no other unusual cyclical or seasonal factors impacting the Company's production.

During the year the Company benefited from continued high energy prices. For 2005, average price realizations were: oil $64.97 per bbl (2004 – n/a); natural gas $7.40 per mcf (2004 – $5.24); and NGL $50.47 per bbl (2004 – $43.15).

Interest of $0.5 million was earned in 2005 (2004 - $0.3 million) on cash balances invested in excess of expenditure requirements.

Stock Compensation

The Company has adopted the fair value method of accounting for stock options and performance warrants. With respect to the performance warrants, the vesting conditions relating to the weighted average trading price of $3.75 and $4.25 were satisfied during the first quarter of 2005. As a result, the vesting period over which the costs were amortized was shortened to reflect the fact that only the timing conditions remain and a non-cash charge in the amount of $1.8 million was taken in the first quarter to reflect the acceleration in the vesting period.

For the year ended December 31, 2005, non cash stock compensation expense related to stock options and performance warrants was $3.3 million versus $0.5 million in 2004. The increase in costs versus 2004 relates to a full year's recognition in 2005 versus 2004, the fact that the performance warrant vesting conditions related to pricing were met, and the number of stock options and performance warrants outstanding increased.

As at December 31, 2005, approximately $0.2 million (2004 - $2.7 million) of non-cash stock compensation expense related to the performance warrants remains unamortized. These costs will be amortized into expense over the remaining vesting period ending April 15, 2006.

General and Administration ("G&A")

G&A costs, net of amounts capitalized to ongoing investment programs, of $1.5 million were incurred during 2005 compared to $0.4 million in 2004. The net amounts represent salaries, employee benefits, office costs, legal and related party services not directly attributable to ongoing exploration and development capital projects. The increase over 2004 is a reflection of the full year of operations and the fact that the Company incurred approximately $0.2 million in costs related to listing on the Toronto Stock Exchange that could not be capitalized.

Effects of Exchange Rate Fluctuations

The Company's operations are conducted primarily in jurisdictions where the United States dollar (US$) and the European Euro (€) are the business currencies. A large proportion of the Company's costs, assets and liabilities during the year ended December 31, 2005 were denominated in Euros. As the Canadian dollar fluctuated during the year, the Canadian dollar equivalent of the working capital appreciated in value resulting in foreign exchange gains being reflected in both the earnings and cash flow amounts.

Depletion and Depreciation

Depletion and depreciation, excluding the $7.5 million impairment provision, was $1.6 million for the year ended December 31, 2005 (2004 - $0.2 million) and relates to the depletion of the France and Canadian assets. Depletion of the France producing properties commenced effective October 1, 2005.

Summary of Quarterly Results

(thousands of Cdn $, except per share amounts)				2005
	Q1	Q2	Q3	Q4
Revenue				
Petroleum & natural gas, net	$ 367	$ 300	$ 272	$ 1,179
Interest income	161	109	91	115
	528	409	363	1,294
Cash flow from operations	183	(195)	218	735
Net loss	(1,788)	(693)	(262)	(8,394)
Capital investment	2,476	585	3,840	4,051
Net loss per share basic and diluted	$ (0.08)	$ (0.03)	$ (0.01)	$ (0.36)

			2004
	Q2	Q3	Q4
Revenue			
Petroleum & natural gas, net	$ –	$ 289	$ 198
Interest income	4	131	172
	4	420	370
Cash flow from operations	(4)	99	237
Net loss	(4)	(191)	(525)
Capital investment	4,229	474	9,650
Net loss per share basic and diluted	$ –	$ (0.01)	$ (0.02)

Due to Related Party

Amounts due to related parties at December 31, 2005 are comprised of an amount due to Vermilion REP SAS of $1.9 million Canadian equivalent (€1.4 million), relating to amounts incurred on the Company's behalf in France, net of $0.2 million due to Verenex relating to Bottrel GORR income not yet received. All intercompany amounts relate to current activities and will be repaid in the normal course of business. The balance has declined from $9.2 million Canadian equivalent (€5.7 million) at December 31, 2004 as a result of payments made to date offset by the activity related to Aquitaine Maritime and St. Lazare 2H, which are contract operated by Vermillion REP SAS, and the La Tonnelle 1 well operated by Lundin.

Verenex entered into a Technical and Administrative Services Agreement with Vermilion on June 28, 2004, whereby Vermilion provides certain financial and administrative services at a cost of $20,000 per month and certain technical, marketing and other services at cost plus 5%, for a period of 18 months ending December 31, 2005. The Agreement is automatically renewed for one-year periods, unless one party provides three months notice not to renew. During the year ended December 31, 2005 Verenex was billed $0.2 million (December 31, 2004 – $0.1) for services provided under this Agreement.

Liquidity and Capital Resources

Verenex will continue to rely primarily on equity to fund future working capital requirements and capital obligations. The Company had a working capital surplus of $33.7 million as at December 31, 2005, including cash and term deposits amounting to $35.5 million. The increase in working capital from $18.3 million ($27.2 million in cash) reported on December 31, 2004 is due to the Company's successful equity financing in December 2005 offset by repayments on its intercompany indebtedness and additional investments in capital projects in France and Libya. The Company has sufficient resources to fulfill its short-term work program commitments.

The majority of the trade receivables relate to amounts associated with the joint venture operations in France and Libya and an accrual for revenues associated with the Bottrel GORR. During the year ended December 31, 2005, the Company received approximately $0.7 million in VAT and GST refunds relating to balances at December 31, 2004. All trade receivables have been assessed for credit risk and no allow ance for doubtful accounts is necessary at this time.

Accounts payable and accrued liabilities have increased since December 31, 2004 due to the cyclical nature of the investment programs in France and Libya.

There are no restrictions on the Company's use of cash as at December 31, 2005.

Verenex is listed on the Toronto Stock Exchange under the stock symbol VNX. In December 2005 the Company successfully completed an equity financing issuing 8,162,500 common shares for gross proceeds of $26.1 million (net $24.7 million after issue costs).

Outlook

Libya

Verenex and Medco have developed an aggressive exploration and appraisal program for Area 47. The Company has identified a robust inventory of exploration prospects and leads and several drilling opportunities adjacent to existing oil discoveries, which will be sufficient to allow Verenex and Medco to meet the five-year seismic acquisition and drilling commitments under the EPSA.

The Company is targeting to invest about Cdn $29 million (net) in Libya in 2006 including seismic, four wells and a workover on an existing oil discovery well. Expenditure pace will be dictated by how quickly the Company can contract one or more drilling rigs. Verenex kicked off the work program in late December 2005 with the start of a large 3-D and 2-D seismic program that will extend into the fourth quarter of 2006. The Company is poised to begin drilling in 2006 as soon as a suitable drilling rig can be contracted.

France

The Company's 2006 budget for France is limited to geological and geophysical work on its onshore permits and the processing and interpretation of the seismic program on Aquitaine Maritime. The new seismic on Aquitaine Maritime is expected to be fully interpreted by the end of April 2006. Vermilion and Verenex are seeking an additional partner in the project to take on the drilling portion of the exploration program. The current plan is to drill one or two wells in the second half of 2007 to test this world-class exploration opportunity.

The Company is continuing to monitor oil and water production performance of the St. Lazare 2H well and is evaluating the potential for follow-up drilling on the Marvilliers permit. On the Parentis concession, Verenex is also evaluating the merits of injecting water in offsetting wells owned by Vermilion in order to increase reservoir pressure and fluid production from the Parentis 222H well. No significant investment is anticipated for these programs for 2006.

North Africa

The Company is continuing to invest time and capital in enhancing its knowledge base of the North African region and in identifying exploration, development and acquisition opportunities.

Verenex will assess participation in other exploration bid rounds and pursue development opportunities through farm-ins and acquisitions in Libya, Algeria, Egypt and Tunisia.

Business Risks and Uncertainties

General

The oil and gas industry is very competitive and is subject to many risks. Many of these risks are outside the Company's control. Management has identified certain key risks and their potential impact on the Company's operations. There is no assurance that commercial quantities of oil and natural gas will be discovered by Verenex.

Ability to Execute Exploration and Development Program

It may not always be possible for the Company to execute its exploration and development strategies in the manner in which the Company considers optimal. The Company's exploration and development programs in Libya involve the need to obtain approvals from the relevant authorities, which may require conditions to be satisfied or the exercise of discretion by the relevant authorities. It may or may not be possible for such conditions to be satisfied.

Drilling and Operating Risks

Exploration and development activities may be delayed or adversely affected by factors outside the control of the Company. These include the availability of drilling and related equipment in the particular areas in which such activities will be conducted. Problems may also arise due to the quality or failure of locally obtained equipment or technical support, which could result in failure to achieve expected target dates for exploration operations or result in a requirement for greater expenditure.

Dependence on Key Personnel

The Company has a small management team and the loss of a key individual or its inability to attract suitably qualified personnel in the future could materially and adversely affect the Company's business. Difficulties may also be experienced in certain jurisdictions in employing and retaining qualified personnel who are willing to work in such jurisdictions.

Additional Financing

To the extent that external sources of capital, including the issuance of additional equity, become limited or unavailable, Verenex's ability to make the necessary capital investments to maintain or expand its oil and gas reserves will be impaired.

Reserve and Resource Estimates

Information on resources and reserves are only estimates and the actual production and ultimate reserves from the properties may be greater or less than the estimates prepared by GLJ. In addition, probable reserves estimates for properties may require revision based on the actual development strategies employed to prove such reserves. Estimated reserves may also be affected by changes in oil and natural gas prices. Declines in the reserves of Verenex, which are not offset by the acquisition or development of additional reserves may reduce the underlying value of shares to Shareholders.

Acquiring, Exploring for and Developing Oil and Natural Gas Reserves

Operational risks in the oil and gas industry include exploration and reserve estimate risks, costs and availability of services and materials, premature reservoir declines, blowouts, well bore collapse, equipment failure and other accidents and adverse weather conditions. The Company maintains insurance in accordance with customary industry practices, however the Company cannot fully insure against all of these risks. Losses from the occurrence of any of these risks could have a material adverse impact on the Company's operations. The Company attempts to monitor, assess and mitigate these risks by retaining an experienced management team and employing experienced professionals.

Foreign Exchange Rates and Commodity Prices

The industry is subject to normal market risks including fluctuations in foreign exchange rates and commodity prices. The Company's operational results and financial condition will be dependent on the prices it receives for oil and natural gas production. Oil and natural gas prices have fluctuated widely during recent years and are determined by supply and demand factors, including weather and general economic conditions as well as conditions in other oil and natural gas regions. While the Company manages its operations in order to minimize exposure to these risks, the Company has not entered into any derivatives or contracts to hedge or otherwise mitigate these exposures.

Foreign Investments

Verenex operates principally outside Canada. As such, the Company's operations are subject to a number of risks over which it has no control. These risks may include risks related to economic, social or political instability or change, terrorism, hyperinflation, currency non-convertibility or instability and changes of laws affecting foreign ownership, government participation, taxation, working conditions, rates of exchange, exchange control, exploration licensing, petroleum and export licensing and export duties as well as government control over domestic oil and gas pricing. The Company operates in such a manner as to minimize and mitigate its exposure to these risks. However, there can be no assurance that the Company will be successful in protecting itself from the impact of all of these risks.

The Company's existing operations in France have well-established fiscal regimes and contract law, which encourage foreign investment. As Verenex expands its operations in Libya and to other countries, the Company will seek out expert advice to ensure it identifies appropriate cost effective risk mitigation strategies.

Environment

The oil and gas industry is subject to environmental regulation pursuant to local, provincial and federal legislation in Canada and similar legislation in other countries. A breach of such legislation may result in the imposition of fines or issuance of clean up orders in respect of Verenex or its properties. Such legislation may be changed to impose higher standards and potentially more costly obligations. The Company has existing policies and practices that ensure its operations conform to the standards and government regulations required for each jurisdiction in which it operates. The Company maintains adequate insurance coverage for environmental risks.

Critical Accounting Estimates

The amounts recorded for depletion and depreciation of property, plant and equipment are based on estimates. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements from changes in such estimates in future years could be significant.

The Company performs a review for asset impairment as required by the Full Cost Accounting Guideline, AcG-16. Any impairment in value is dependent upon an independent reservoir engineer's assessment of the deliverability and reserves associated with certain wells and the outlook for world prices for oil and natural gas.

New Accounting Standards and Changes in Accounting Standards for 2006 and 2007

In April 2005 the Canadian Institute of Chartered Accountants issued the following new Handbook Sections: Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments – Recognition and Measurement; and Section 3865, Hedges. The effective date for adoption for all four sections is on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. However an entity that has previously issued interim financial statements prepared in accordance with generally accepted accounting principles for a period within a particular fiscal year is precluded from adopting this section until the beginning of its next fiscal year. As well, early adoption of any one of these standards also requires early-adoption of at least two of the other three.

These new accounting standards for Canadian GAAP will converge more closely with the US GAAP as all financial instruments will be recorded on the balance sheet at fair value and changes in fair value will be included in earnings, except for derivative financial instruments designated as hedges, for which changes in fair value will be included in comprehensive income.

The Company has not chosen early adoption of these new accounting standards and has not assessed the future impact these sections will have on the financial statements.

Disclosure Controls and Procedures Over Financial Reporting

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), on a timely basis so appropriate decisions can be made regarding public disclosure. As at December 31, 2005, the CEO and CFO have evaluated the effectiveness of the Company's disclosure controls and procedures as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators and have concluded that such disclosure controls and procedures are effective.

financial statements

management's report

The Management of Verenex Energy Inc. is responsible for the integrity and objectivity of the information contained in this Annual Report and for the consistency between consolidated financial statements and other financial operating data contained elsewhere in the Report. The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgment, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and reflect fairly the Company's financial position, results of operations and changes in financial position, within reasonable limits of materiality and within the framework of the accounting policies outlined in the notes to the consolidated financial statements.

Management has established and maintains a system of internal control, which is designed to provide reasonable assurance that assets are safeguarded from loss, or unauthorized use and the financial information is reliable and accurate.

The consolidated financial statements have been examined by external auditors. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and financial condition of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

James D. McFarland
President & Chief Executive Officer
February 23, 2006

Kenneth D. Hillier
Chief Financial Officer

auditors' report

To the Shareholders of Verenex Energy Inc.:

We have audited the consolidated balance sheets of Verenex Energy Inc. (the "Company") as at December 31, 2005 and December 31, 2004 and the consolidated statements of loss and deficit and cash flows for the year ended December 31, 2005 and the period from June 29, 2004 to December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and December 31, 2004 and the results of its operations and its cash flows for the year ended December 31, 2005 and the period from June 29, 2004 to December 31, 2004 in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
February 23, 2006

consolidated balance sheets

(thousands of Cdn $) audited		December 31, 2005		December 31, 2004
Assets				
Current assets				
Cash and cash equivalents	$	**35,546**	$	27,237
Accounts receivable		**711**		841
Crude oil inventory		**74**		–
Prepaid expenses and other		**13**		3
		36,344		28,081
Capital assets (Note 4)		**18,277**		16,387
	$	**54,621**	$	44,468
Liabilities and Shareholders' Equity				
Current liabilities				
Accounts payable and accrued liabilities	$	**946**	$	586
Due to related party (Note 6)		**1,660**		9,185
Taxes payable (Note 7)		**73**		28
		2,679		9,799
Asset retirement obligations (Note 5)		**37**		–
		2,716		9,799
Commitments and contingencies (Note 14)				
Shareholders' equity				
Share capital (Note 8)		**60,560**		35,308
Contributed surplus (Note 8)		**3,592**		471
Deficit		**(12,247)**		(1,110)
		51,905		34,669
	$	**54,621**	$	44,468

See accompanying notes to the Consolidated Financial Statements

Approved by the Board of Directors:

James D. McFarland
Director

William T. Fanagan
Director

consolidated statements of loss and deficit

(thousands of Cdn $, except share and per share amounts) audited	Year ended December 31, 2005	Period ended December 31, 2004 (note 1)
Revenue		
Petroleum and natural gas, net	$ 2,118	$ 487
Interest income	476	307
	2,594	794
Expenses		
Production	77	–
Transportation	25	–
General and administration	1,478	434
Stock based compensation (Note 9)	3,264	471
Depletion and depreciation (Note 4)	1,559	199
Impairment write-down (Note 4)	7,541	–
Foreign exchange (gain)/loss	(286)	382
	13,658	1,486
Loss before taxes	(11,064)	(692)
Capital taxes (Note 7)	73	28
Net loss	(11,137)	(720)
Deficit, beginning of period	(1,110)	(390)
Deficit, end of period	$ (12,247)	$ (1,110)
Net loss per share basic and diluted (Note 10)	$ (0.48)	$ (0.03)
Weighted average number of shares outstanding (Note 10):		
Basic	22,971,271	22,511,646
Diluted	24,517,041	22,776,800

See accompanying notes to the Consolidated Financial Statements

consolidated statements of cash flows

(thousands of Cdn $) audited	Year ended December 31, 2005	Period ended December 31, 2004 (note 1)
Cash and cash equivalents provided by (used in):		
Operating activities		
Net loss	$ (11,137)	$ (720)
Items not affecting cash		
Stock based compensation	3,264	471
Depletion and depreciation	1,559	199
Impairment write-down	7,541	–
Unrealized foreign exchange (gain)/loss	(286)	382
Cash flow from operations before changes in working capital	941	332
Changes in non-cash operating working capital (Note 13)	420	25
	1,361	357
Investing activities		
Acquisition and expenditures on petroleum and natural gas properties	(10,952)	(14,353)
Cash acquired through the acquisition of Prairie Fire Oil and Gas Ltd.	–	62
Changes in non-cash investing working capital (Note 13)	666	(689)
	(10,286)	(14,980)
Financing activities		
Issue of common shares for cash, net of share issue costs	25,109	32,606
(Payments) of/advances from related party (Notes 6 and 13)	(7,525)	9,185
	17,584	41,791
Foreign exchange (gain)/loss on cash held in a foreign currency	(350)	69
Net change in cash and cash equivalents	8,309	27,237
Cash and cash equivalents, beginning of period	27,237	–
Cash and cash equivalents, end of period	$ 35,546	$ 27,237
Cash taxes paid	28	–
Cash interest received	476	307

See accompanying notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

For the year ended December 31, 2005 (thousands of Cdn $, except as noted) audited

1. Basis of Presentation

Verenex Energy Inc. (the "Company" or "Verenex") was established on June 29, 2004, by way of a "reverse takeover" pursuant to an amalgamation agreement dated May 27, 2004. Verenex was formed by the amalgamation of Verenex Energy Inc., a private Company ("Private Verenex"), and Prairie Fire Oil & Gas Ltd. ("Prairie Fire"), to pursue oil and gas exploration activities in France and other international exploration, development and acquisition opportunities. Under the amalgamation agreement, each common share of Private Verenex was converted into one common share of the Company, and each Prairie Fire common share was converted into 0.04 of a common share of the Company. As a result of the amalgamation, the former shareholders of Private Verenex owned more than 95% of the Company. Accordingly, the business combination has been accounted for as a reverse takeover using the purchase method, with Private Verenex being the acquiring Company. In accordance with reverse takeover accounting, the financial statements are a continuation of Private Verenex and reflect the fair values of the acquired assets and liabilities of Prairie Fire while the assets and liabilities of Verenex continue to be accounted for at carrying value. Verenex is a public Company and commenced trading on the TSX Venture Exchange on July 20, 2004 and graduated to the Toronto Stock Exchange on April 19, 2005.

As a result of the foregoing, the comparative consolidated statements of loss and deficit and the consolidated statements of cash flows are for the period June 29, 2004 to December 31, 2004. Private Verenex had no operations prior to June 29, 2004.

2. Significant Accounting Policies

a) Principles of consolidation

The consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles and include the accounts of the Company and its subsidiaries, all of which are wholly owned, on a consolidated basis. All material intercompany accounts and transactions have been eliminated upon consolidation.

The Company conducts most of its exploration, development and production activities jointly with others and these financial statements reflect only the Company's proportionate interest.

b) Cash and cash equivalents

Cash and cash equivalents include monies on deposit and short-term investments accounted for at cost having a maturity date of not more than 90 days.

c) Petroleum and natural gas operations

The Company uses the full-cost method of accounting for petroleum and natural gas operations and accordingly, capitalizes all exploration and development costs into country by country cost centers. These costs include land acquisition, geological and geophysical costs, drilling (including related overhead) on producing and non-producing properties and other carrying charges on unproven properties. Proceeds of disposition are applied against net costs capitalized with no gain or loss recognized except when the disposition results in a greater than 20% change in the rate of depletion and depreciation.

The carrying value of the Company's petroleum and natural gas properties is limited to the sum of the undiscounted cash flows expected to result from the Company's proved reserves using forecast prices. If the carrying value is not fully recoverable, the amount of impairment is measured by comparing the carrying amounts of the capital assets to an amount equal to the estimated net present value of future cash flows from proven plus probable reserves. This calculation incorporates risks and uncertainties in the expected future cash flows, which are discounted using a risk-free rate. Any excess carrying value above the net present value of the future cash flows would be recorded as a permanent impairment and charged to earnings.

d) Depletion and depreciation and impairment

Cost centers from which there has been no commercial production are not subject to depletion until commercial production commences. The capitalized costs are periodically evaluated to determine whether it is likely such costs will be recovered in the future. To the extent there are costs, which are unlikely to be recovered in the future, they would be recorded as a permanent impairment and charged to earnings.

Depletion of petroleum and natural gas costs is calculated for each cost center on the unit-of-production method based on estimated proven reserves, before royalties, as determined by independent engineers. The cost of significant unevaluated properties is excluded from the calculation of depletion. For purposes of depletion calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content based on a conversion ratio of 6,000 cubic feet of natural gas to a barrel of oil.

Furniture and equipment are recorded at cost and are being amortized on a declining-balance basis at rates of 20% to 50% per year.

e) Asset retirement obligations

The Company accounts for its asset retirement obligations under Canadian Institute of Chartered Accountants ("CICA") Handbook, section 3110, Asset Retirement Obligations. This standard focuses on the recognition and measurement of liabilities related to legal obligations associated with the future retirement of property, plant and equipment. Under this standard, these obligations are initially measured at fair value determined as the estimated future costs discounted to the present value and subsequently adjusted for the accretion of the discount factor and any changes in the underlying cash flows. The asset retirement cost is capitalized to the related asset and amortized into earnings over time. The Bottrel GORR properties have no obligations for abandonment or reclamation.

f) Revenue recognition

Revenues associated with the sale of crude oil, natural gas and liquids are recorded when title passes to the customer. Oil and gas revenues represent the Company's share and are recorded net of royalty payments to governments and other mineral interest owners.

g) Stock-based compensation plan

The Company has a stock-based compensation plan for employees, directors and officers of the Company and its subsidiaries. The Company has also issued performance warrants in conjunction with a private placement to certain employees, officers and directors as described in Note 9. The fair value of the options and performance warrants is estimated using the Black-Scholes option-pricing model that takes into account, as of the grant date: exercise price, expected life, current price, expected volatility, expected dividends and risk-free interest rates.

The fair value of the stock based compensation is recognized over the vesting period of the stock options granted and the estimated life of the performance warrants as a compensation cost with a corresponding increase recorded to contributed surplus.

Upon exercise of the stock options or performance warrants, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

See Note 9 for a description of the plan.

h) Foreign currency translation

Foreign currency balances of foreign subsidiaries that are considered to be integrated are translated on the following basis:

- Monetary assets and liabilities are translated at the rates of exchange prevailing at the balance sheet dates;
- Non-monetary assets, liabilities and related depreciation and depletion expense are translated at historical rates; and
- Sales, other revenues, royalties and all other expenses are translated at the average rate of exchange during the month in which they are recognized.

Any resulting foreign exchange gains and losses are included in earnings in the period.

i) Income taxes

Income taxes are calculated using the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the consolidated financial statements of the Company and their respective tax bases, using substantively enacted income tax rates and tax laws that will be in effect when the differences are expected to reverse. Future income tax assets are recognized to the extent it is more likely than not that sufficient future taxable income will be available to allow the future income tax asset to be realized. The effect of a change in income tax rates on future tax liabilities and assets is recognized in earnings in the period in which the change occurs.

j) Measurement uncertainty and use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses including asset retirement obligations, depletion, depreciation and the fair value of stock options and performance warrants. The ceiling test is based upon estimates of fair values of unproved properties, proved reserves, petroleum and natural gas prices, future costs and other assumptions. These estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates could be significant.

k) Per share amounts

Net loss per share is calculated using the weighted average number of shares outstanding during the period. Diluted net loss per share is calculated using the treasury stock method to determine the dilutive effect of stock options and performance warrants. The treasury stock method assumes that the proceeds received from the exercise of "in the money" stock options and performance warrants are used to purchase shares at the average market share price during the period.

3. Amalgamation of Prairie Fire Oil & Gas Ltd.

On June 29, 2004, Private Verenex amalgamated with Prairie Fire. The transaction has been accounted for as an acquisition of Prairie Fire by Private Verenex.

The fair values of Prairie Fire's net assets at June 29, 2004 were as follows:

Cash	$	62
Accounts receivable		25
Accounts payable		(8)
Purchase price	$	79

On June 29, 2004, 188,000 common shares were issued as consideration for the acquisition of Prairie Fire (see Note 8).

4. Capital Assets

	December 31, 2005					
		Cost		**Accumulated Depletion, Depreciation & Amortization**		**Net Book Value**
Petroleum and natural gas properties and equipment	$	27,242	$	9,244	$	17,998
Furniture and equipment		332		53		279
	$	27,574	$	9,297	$	18,277

	December 31, 2004					
		Cost		**Accumulated Depletion, Depreciation & Amortization**		**Net Book Value**
Petroleum and natural gas properties and equipment	$	16,530	$	192	$	16,338
Furniture and equipment		56		7		49
	$	16,586	$	199	$	16,387

The Company capitalized $1.7 million of general and administrative costs relating to exploration and development activities in 2005 (2004 – $0.8 million).

In France, the net proceeds from test oil production from the Parentis 222H and St. Lazare 2H wells totaling $0.3 million for the nine months ended September 30, 2005 have been offset against the cumulative well costs. During the fourth quarter of 2005, the Company determined that both the St. Lazare 2H and the Parentis 222H wells were commercial on a go forward basis and the associated revenues and expenses were included in the Company's operating results effective October 1, 2005.

The Company performs a review for asset impairment as required by the Full Cost Accounting Guideline, AcG-16. The Company applied a ceiling test to its oil and gas assets using GLJ's forecast of future market prices of:

Year	WTI Oil (US$/bbl)	Foreign Exchange Rate (US/Cdn$)	Brent (US$/bbl)	AECO-C Gas (Cdn$/mmbtu)
2006	57.00	0.85	55.50	10.60
2007	55.00	0.85	53.50	9.25
2008	51.00	0.85	49.50	8.00
2009	48.00	0.85	46.50	7.50
2010	46.50	0.85	45.00	7.20
2011	45.00	0.85	43.50	6.90
2012	45.00	0.85	53.50	6.90
2013	46.00	0.85	44.50	7.05
2014	46.75	0.85	45.25	7.20
2015	47.75	0.85	46.25	7.40
2016	48.75	0.85	47.25	7.55
Thereafter	+2%/year	+2%/year	+2%/year	+2%/year

The Company completed a review for asset impairment for the France full cost pool, including the St. Lazare 2H, Parentis 222H and La Tonnelle 1 wells. Based on an independent reservoir engineer's (GLJ Petroleum Consultants Ltd. ("GLJ")) assessment of the deliverability and reserves associated with the wells and the outlook for world prices for oil and natural gas, it was determined that a $7.5 million ceiling test write-down was required to reflect an impairment in these assets, including the investment to date in the expired permit at Les Trois Lagunes.

Depletion and depreciation, excluding the impairment provision noted above, was $1.6 million for the year ended December 31, 2005 (2004 - $0.2 million) and relates to the depletion of the France and Canadian assets. Approximately, $6.0 million in undeveloped land (2004 - $13.8 million) in France was excluded from the depletion calculation.

5. Asset Retirement Obligations

The Company records the fair value of legal obligations associated with the retirement of all of its long-lived tangible assets, including its producing well sites but excluding the assets associated with the Bottrel GORR for which the Company has no retirement obligations. The estimation of these costs is based on engineering estimates using current costs and technology and in accordance with current legislation and industry practice.

With the commencement of production in France, Verenex recognized a $37,000 liability associated with the St. Lazare 2H and Parentis 222H wells (2004 – nil). These costs are assumed to be paid in 40 to 45 years. The Company used a credit risk adjusted risk-free rate of 8% and an inflation rate of 1.5% to calculate the net present value of the future retirement obligation. The Company's gross obligation is currently estimated at $0.3 million (2004 – nil).

6. Related Party Transactions

Vermilion REP SAS is a 100% owned subsidiary of Vermilion Energy Trust, which is a significant shareholder in Verenex. Vermilion REP SAS, as contract operator in France, paid for various expenditures on behalf of Verenex. These transactions were measured at the exchange amount being the consideration established and agreed to by the related parties. These transactions were undertaken under the same terms and conditions as transactions with non-related parties. Amounts due to related party are comprised of an amount due to Vermilion REP SAS of $1.9 million Canadian equivalent (€1.4 million), relating to amounts incurred on the Company's behalf in France, net of $0.5 million due to Verenex relating to Bottrel royalty income not yet received.

The Bottrel GORR provided $1.4 million of royalty income in 2005 (2004 – $0.5 million).

Verenex entered into a Technical and Administrative Services Agreement with Vermilion on June 28, 2004, whereby Vermilion provides certain financial and administrative services at a cost of $20,000 per month and certain technical, marketing and other services at cost plus 5%, for a period of 18 months ending December 31, 2005. The Agreement is automatically renewed for one year periods, unless one party provides three months notice not to renew. During 2005 Verenex was billed $0.2 million (2004 – $0.1 million) for services provided under this Agreement.

7. Taxes

Taxes relate to capital taxes. The Company has an unrecognized future income tax asset of $4.3 million (December 31, 2004 – $0.4 million) relating to the difference in the carrying values and the tax bases of the assets in France (2005 – $2.7 million; 2004 – nil) and Canada (2005 – $1.6 million; 2004 – 0.4 million).

As at December 31, 2005 the Company had estimated tax losses of approximately $1.7 million in Canada (2004 – $1.7 million) and approximately Canadian equivalent $10.5 million (2004 - $0.8 million) in France. The Canadian tax losses expire in 2014 and the France tax losses have no expiry date. No future tax benefit has been recorded relating to these tax losses.

8. Share Capital

Authorized

Unlimited number of common shares
Unlimited number of preferred shares

Issued

	Number of Shares	Amount
Opening balances as at June 29, 2004	1	$ –
Issued through private placement to directors for cash	280,000	700
Issued through private placements for cash	11,268,900	28,172
Issued for cash related to resource properties in France	5,644,414	3,400
Issued for resource properties in Canada	4,355,585	2,624
Issued through founders private placement for cash	777,700	1,945
Share issue costs	–	(1,612)
Shares issued on Prairie Fire acquisition (Note 3)	188,000	79
Opening balance as at January 1, 2005	22,514,600	$ 35,308
Issued for cash on warrant and option exercise	153,333	424
Issued through financing for cash	8,162,500	26,120
Share issue costs		(1,435)
Transferred from contributed surplus on warrant and option exercise		143
Balance as at December 31, 2005	30,830,433	$ 60,560

Contributed surplus

	December 31, 2005	December 31, 2004
Opening balance	$ 471	$ –
Stock compensation expense	3,264	471
Transferred to share capital on warrant and option exercise	(143)	–
Ending balance	$ 3,592	$ 471

9. Stock Compensation Plan

a) The Company has a stock option plan that allows the directors, officers and employees of the Company to be granted rights to acquire common shares of the Company. Shareholders approved an amendment to the Company's Stock Option Plan (the "Plan") at the Company's Annual General Meeting on May 4, 2005. Under the amendment, the Company adopted a "rolling" stock option plan that reserves a maximum of 10% of the aggregate number of issued and outstanding common shares. The Plan previously in place reserved a fixed number of common shares. The terms of the amended Plan are otherwise unchanged.

Stock option exercise prices are equal to the market price for the common shares on the date immediately prior to the date the stock option is granted.

Stock options granted in any period vest over three years and expire five years after the grant date.

The following table summarizes information about the stock option plan:

		December 31, 2005
	Number of Stock Options	Weighted Average Exercise Price
Opening balance, June 29, 2004	–	$ –
Granted	1,535,000	2.51
Opening balance, January 1, 2005	1,535,000	$ 2.51
Granted	1,212,000	3.54
Exercised	(53,333)	2.50
Cancelled	(106,667)	2.50
Closing balance, December 31, 2005	2,587,000	$ 2.99

The following table summarizes information about options outstanding and exercisable as at December 31, 2005:

Exercise Price ($)	**Options Outstanding**	**Remaining Contractual Life** (Years)	**Exercisable Options**	**Remaining Contractual Life** (Years)
2.50 – 3.00	1,375,000	3.5	458,333	3.5
3.01 – 3.50	980,000	4.8	–	–
4.51 – 5.00	220,000	4.7	–	–
5.01 – 5.50	12,000	4.9	–	–
2.50 – 5.50	2,587,000	4.1	458,333	3.5

b) The Company has also issued performance warrants. One-half of the performance warrants become exercisable if the holder continues in their capacity with the Company until April 15, 2005 and if at any time during the term, the one-month weighted average trading price of the shares is equal to or greater than $3.75 per share. One-half will also be exercisable if the one-month weighted average trading price of the shares is equal to or greater than $4.25 per share and the holder continues in their capacity until April 15, 2006. The performance warrants expire at the close of business on June 28, 2011.

The performance warrant vesting conditions relating to the weighted average trading price of $3.75 and $4.25 were satisfied in the first quarter of 2005. As a result, the vesting period over which the compensation costs were amortized was reduced and a non-cash expense in the amount of $1.8 million was recognized in the first quarter to reflect the acceleration in the vesting period.

As at December 31, 2005, approximately $0.2 million (December 31, 2004 – approximately $2.7 million) of non-cash stock compensation expense related to the performance warrants remains unamortized. These non-cash costs will be amortized into expense over the remaining vesting period ending April 15, 2006.

The following table summarizes information about the performance warrants:

		December 31, 2005
	Number of Performance Warrants	Weighted Average Exercise Price
Opening balance, June 29, 2004	–	$ –
Granted	1,944,250	2.50
Opening balance, January 1, 2005	1,944,250	$ 2.50
Granted	112,500	3.40
Exercised	(55,000)	2.50
Cancelled	(55,000)	2.50
Closing balance, December 31, 2005	1,946,750	$ 2.55

The following table summarizes information about performance warrants outstanding and exercisable as at December 31, 2005:

Exercise Price ($)	**Performance Warrants Outstanding**	**Remaining Contractual Life** (Years)	**Exercisable Performance Warrants**	**Remaining Contractual Life** (Years)
2.50 – 3.00	1,834,250	5.5	917,125	5.5
3.01 – 3.50	112,500	6.0	–	–
2.50 3.50	1,946,750	5.5	917.125	5.5

In 2005, non-cash stock compensation expense related to stock options and performance warrants was $3.3 million (2004 – $0.5 million).

The fair value of the options and performance warrants is determined using the Black Scholes option-pricing model that takes into account, as of the grant date: exercise price, expected life, current price, expected volatility, expected dividends and risk-free interest rates.

The assumptions used in the computation of the fair value of the stock options and performance warrants for both 2005 and 2004 are as follows:

	Stock Options	**Performance Warrants**
Risk free interest rate	4.5%	4.5%
Expected dividends	–	–
Expected life	5 years	7 years
Volatility	50%	50%

The fair value of the options and performance warrants granted during 2005 is $1.72 and $1.85 respectively (2004 - $1.22 and $1.13 respectively).

c) During the year, 410,000 share appreciation rights were granted to employees at an exercise price of $3.24. Each right entitles the participant to receive from the Company an amount equal to the positive difference, if any, obtained by subtracting the assigned amount from the closing trading price of the common shares on the Toronto Stock Exchange. As at December 31, 2005, the trading price of the Company's stock on the Toronto Stock Exchange was below the exercise price and therefore no costs have been recorded.

10. Per Share Amounts

	For the Year Ended December 31, 2005	**For the Period Ended December 31, 2004**
Weighted average number of common shares outstanding	22,971,271	22,511,646
Shares issuable pursuant to stock options	695,689	265,154
Shares issuable pursuant to performance warrants	850,081	–
Weighted average number of diluted common shares outstanding	24,517,041	22,776,800

The weighted average diluted shares outstanding include all stock options in the money from the date of grant or the beginning of the period. The weighted average diluted shares include the performance warrants which are treated as contingently issuable shares and are included from the beginning of the period that all of the conditions for issue were satisfied.

11. Segmented Information

The Company operates in three different geographical locations and has chosen to disclose key financial data based on those jurisdictions. Where not specifically identified, income statement line items, such as interest revenue, relate to Canada. Any allocations of costs between segments are done at cost and based on time allocated to the various projects.

	For the Year Ended December 31, 2005	For the Period Ended December 31, 2004
Petroleum and natural gas revenues, net		
Canada	1,398	487
France	720	–
	$ 2,118	$ 487
Net earnings (loss)		
Canada	(3,342)	(212)
France	(7,795)	(508)
Libya	–	–
	$ (11,137)	$ (720)
Funds generated from operations		
Canada	603	466
France	338	(134)
Libya	–	–
	$ 941	$ 332
Capital expenditures		
Canada	1,270	3,773
France	7,765	12,813
Libya	1,917	–
	$ 10,952	$ 16,586

	December 31, 2005	December 31, 2004
Identifiable assets		
Canada	$ 38,406	$ 27,719
France	13,804	16,749
Libya	2,411	–
	$ 54,621	$ 44,468

12. Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and the amount due to related party approximated their fair values as at December 31, 2005 as a result of the short-term nature of these instruments.

The oil and gas industry is subject to risks including fluctuations in foreign exchange rates and commodity prices. The Company's operating results and financial condition will be dependent on the prices it receives for oil and natural gas production. Oil and natural gas prices have fluctuated during recent years and are determined by supply and demand factors, including weather and general economic conditions as well as conditions in other oil and natural gas regions. While Verenex manages its operations in order to minimize exposure to these risks, the Company has not entered into any derivatives or contracts to hedge or otherwise mitigate these fluctuations.

13. Statements of Cash Flow

Changes in non-cash working capital:

	For the Year Ended December 31, 2005	For the Period Ended December 31, 2004
Accounts receivable	$ 711	$ 841
Crude oil inventory	(74)	–
Prepaid expenses and other	(10)	–
Accounts payable and accrued liabilities	666	(689)
Due to related party	(7,777)	8,341
Taxes payable	45	28
	$ (6,439)	$ 8,521

Changes in non-cash working capital relating to:		
Operating activities	$ 420	$ 25
Investing activities	666	(689)
Financing activities	(7,525)	9,185
	$ (6,439)	$ 8,521

14. Commitments and Contingencies

				Payments Due by Period
Contractual Obligations	**Total**	**Less than 1 Year**	**1 to 3 Years**	**4 to 5 years**
Operating leases	$ 352	$ 183	$ 169	$ –
Work program commitments:				
Libya	12,000	4,500	–	$ 7,500
France	250	250	–	–
	12,250	4,750	–	7,500
Total contractual obligations	$ 12,602	$ 4,933	$ 169	$ 7,500

Office leases

Effective May 1, 2005 Verenex Energy Area 47 Libya Limited, a 100% owned subsidiary, entered into a two-year contract to sublease office space in Tripoli, Libya at a cost of approximately $3,750 per month payable annually in advance. The Company has the option to extend the term of the lease by up to three years under the same terms. Effective November 1, 2005 additional office space was subleased in Tripoli at a cost of $1,800 per month payable in advance. Under the terms of the Joint Operating Agreement with Medco International Ventures Limited ("Medco"), 50% of these costs are expected to be recoverable.

Effective May 1, 2005, the Company agreed to sublease additional floor space in Calgary from Vermilion. The terms of the amended agreement provide office space at a cost of $6,339 per month plus a monthly operating cost charge of $6,112 per month. This agreement expires October 30, 2007.

Libya

On January 30, 2005 the Company announced it had been selected as a successful bidder in Libya's Bid Round 1 for an Exploration and Production Sharing Agreement ("EPSA"). Verenex has the right to explore for oil and gas in Area 47, a 6,182 square kilometre area in the Ghadames Basin in northwest Libya. Verenex is the Operator with a 50% interest in Area 47 in partnership with Medco, which holds the remaining 50% interest. The EPSA sets out the required minimum work program during the initial five-year exploration and appraisal period and defines the terms for development, during a 25-year exploitation period, of any commercial discoveries made during the initial five-year period.

Under the terms of the EPSA for Area 47, Verenex and Medco (the "contractor group") are required to acquire new seismic, including 1,000 kilometres of 2-D and 200 square kilometres of 3-D, and drill three exploration wells during the five-year exploration and appraisal period. All exploration and appraisal costs during this period, including the minimum commitment program and any additional seismic and drilling, will be borne 100% by Verenex and Medco. If the contractor group fails to carry out the minimum commitment program it will be required to pay a penalty based on a defined per well cost and a unit cost for seismic (per square kilometre for 3-D and per kilometre for 2-D). The maximum exposure is US $20 million (US $10 million net to Verenex).

If a discovery is made on the block and the Parties (the Libyan National Oil Company ("NOC") and the contractor group) unanimously agree that it is commercial, a joint operating company would be established to operate the discovery. Development capital expenditures would be shared 50% by the contractor group and 50% by the NOC. Operating costs would be shared on the basis of the production allocation split, with the contractor group paying 13.7% of these costs and the NOC 86.3%. The NOC pays 100% of all royalties and Libyan taxes incurred on each discovery, including the contractor group share.

As at December 31, 2005, the Contractor group had awarded a Canadian equivalent $9.0 million (US $7.5 million) (gross) (Cdn $4.5 million net to Verenex) contract for its 2006 seismic program and work began in late December 2005 on surveying for the first 243 square kilometre 3-D seismic shoot in the southern part of Area 47. No other contracts had been awarded at year-end 2005 relating to the EPSA commitments and therefore the remaining funding has been included in the four to five year category.

France

The Company has commitments to its partner in France on the Aquitaine Maritime permit.

At Aquitaine Maritime, Vermilion (the "Operator") awarded a contract to Petroleum Geo-Services ("PGS") to undertake a combined 2-D and 3-D offshore seismic program. The seismic acquisition and subsequent processing is estimated to cost approximately $7.9 million Canadian equivalent (US $6.6 million) (gross). The program commenced on September 3, 2005 and the acquisition phase was completed on October 14, 2005. The new seismic is currently being interpreted to remap leads and prospects with expected completion by the end of April 2006. Verenex has a 50% participating interest in the permit and expects its share of the costs to be approximately Cdn $4.2 million. As at December 31, 2005, the Company had recorded approximately Cdn $3.7 million in expenditures relating to this commitment.

company information

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Vermilion Energy Trust
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Claudio A. Ghersinich [4]
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Gerry J. Macey [2,3,4]
Calgary, AB

James D. (Jim) McFarland
President & CEO
Verenex Energy Inc.
Calgary, AB

Johannes J. (Jim) Nieuwenburg [2,4]
Calgary, AB

1 Chairman
2 Audit Committee
3 Governance and Human Resources Committee
4 Independent Reserves and Environment, Health and Safety Committee

Officers & Key Personnel

James D. (Jim) McFarland, P. Eng.
President & CEO

Kenneth D. (Ken) Hillier, C.A.
Chief Financial Officer

Blair Anderson
Manager, Exploration

Giuseppe (Joe) Arcuri
Manager, Geophysics

Fadi Nammour, P. Eng.
Manager, Business Development & Operations

Don Shepherd, P. Eng.
General Manager, Libya

Charles W. Berard
Corporate Secretary
Partner, Macleod Dixon LLP

Auditors

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Calgary, Alberta

Bankers

The Toronto-Dominion Bank
Calgary, Alberta

Evaluation Engineers

GLJ Petroleum Consultants Ltd.
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Annual General & Special Meeting

May 3, 2006
10:00 am
Metropolitan Conference Centre
Strand/Tivoli Room
333 – 4th Avenue SW
Calgary, Alberta

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Verenex Energy Inc. ("Verenex" or the "Company") is a Canada-based, international oil and gas exploration and production company with a world-class exploration portfolio in the Ghadames Basin in Libya and the Bay of Biscay offshore France. Verenex was established by Vermilion Energy Trust ("Vermilion") in March 2004 to advance the exploration program that Vermilion had begun in France, prior to its conversion to an income trust in 2003, and to pursue other international exploration, development and acquisition opportunities outside Canada. Verenex is a public company that resulted from the amalgamation of a formerly private company, Verenex Energy Inc., a wholly owned subsidiary of Vermilion, and Prairie Fire Oil & Gas Ltd. under the laws of the Province of Alberta on June 29, 2004. In conjunction with the amalgamation, Verenex successfully completed a Founders' Private Placement and Secondary Private Placement

verenex energy inc. we can & will make it happen.

with investors in Canada, the US and Europe to raise Cdn $30.8 million (gross before fees) in equity. By virtue of its participation in the Secondary Private Placement and its transfer to Verenex of participating interests in Vermilion exploration lands in France and a royalty on a producing oil and gas asset held by Vermilion in Alberta, Canada, Vermilion retained a significant interest in Verenex. In December 2005, Verenex conducted a Cdn $26.1 million (gross before fees) equity financing in which Vermilion again participated. Vermilion currently holds a 49.3% interest in Verenex. Verenex was listed for trading on the TSX Venture Exchange in Canada on July 20, 2004 and subsequently graduated to the Toronto Stock Exchange on April 19, 2005. Verenex Energy Inc. ("Verenex" or the "Company") is a Canada-based, international oil and gas exploration and production company with a world-class exploration portfolio in the Ghadames Basin in Libya

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